STATEMENT OF
HONORABLE DONALD J. DEVINE
DIRECTOR, U.S. OFFICE OF PERSONNEL MANAGEMENT
before the
COMMITTEE ON POST OFFICE AND CIVIL SERVICE
U.S. HOUSE OF REPRESENTATIVES
on
DEVELOPMENT OF A NEW RETIREMENT PLAN
FOR FEDERAL EMPLOYEES COVERED
BY SOCIAL SECURITY
February 23, 1984

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE:

THANK YOU FOR INVITING ME TO APPEAR THIS MORNING TO DISCUSS THE ISSUES INVOLVED IN ESTABLISHING A RETIREMENT SYSTEM FOR NEW FEDERAL EMPLOYEES WHO ARE COVERED BY SOCIAL SECURITY. I AM ACCOMPANIED TODAY BY JAMES W. MORRISON, JR., OPM'S ASSOCIATE DIRECTOR FOR COMPENSATION, AND JEAN M. BARBER, ASSISTANT DIRECTOR FOR FINANCIAL CONTROL AND MANAGEMENT.

I WOULD LIKE TO BEGIN BY EXPRESSING MY PERSONAL APPRECIATION TO YOU, MR. CHAIRMAN, AND THE OTHER MEMBERS OF THE COMMITTEE, FOR BEGINNING DISCUSSIONS ON THIS ISSUE ON SO TIMELY A BASIS. I THINK WE ARE ALL AWARE THAT WE MUST HAVE SERIOUS DISCUSSIONS THIS YEAR, IF WE ARE GOING TO BE ABLE TO PRODUCE AN EQUITABLE RETIREMENT PACKAGE FOR NEW EMPLOYEES NEXT YEAR.

MUCH OF THE NEEDED ANALYTICAL GROUNDWORK IS WELL UNDER WAY, BOTH THROUGH THE WORK BEING DONE BY LEGISLATIVE BRANCH STAFF AND THEIR CONSULTANT, AND BY OPM. THEREFORE, IT IS TIMELY TO BEGIN POLICY-LEVEL DISCUSSIONS AS WELL.

IN YOUR LETTER INVITING ME TO APPEAR TODAY, YOU HAVE OUTLINED A COMPREHENSIVE AGENDA. I WOULD LIKE TO RESPOND TO EACH CONCERN IN THE SAME ORDER. BEFORE I BEGIN, I WISH TO EMPHASIZE THAT I AM PURPOSELY BEING GENERAL IN MY REMARKS, SO THAT WE CAN PROCEED IN THE MOST CONSTRUCTIVE MANNER. THE ADMINISTRATION HAS OFFERED PROPOSALS FOR REFORM OF THE CURRENT SYSTEM IN THE FY-84 BUDGET, AND HAS RE-ENDORSED THEM IN THE FY-85 BUDGET. WE ARE OPEN TO DISCUSSION OF THESE, THEY ARE NOT OUR FINAL WORD. HOWEVER, WE HAVE NOT MADE SPECIFIC PROPOSALS FOR A PLAN TO COVER NEW EMPLOYEES. WE BELIEVE THAT BEFORE WE MAKE PROPOSALS FOR THAT PLAN, WE SHOULD SEEK THE VIEWS OF FEDERAL EMPLOYEES, OUTSIDE GROUPS AND MEMBERS OF CONGRESS. WE ARE ENTERING THESE DISCUSSIONS WITH AN OPEN MIND, AND A COMMITMENT TO WORK WITH ALL INTERESTED PARTIES TOWARDS ATTAINING OUR OBJECTIVE OF A FEDERAL RETIREMENT PLAN FOR NEW EMPLOYEES THAT WILL ENHANCE OUR ABILITY TO ATTRACT AND RETAIN THE QUALITY EMPLOYEES NEEDED TO DO THE GOVERNMENT'S WORK, AND BE FAIR TO BOTH EMPLOYEES AND TAXPAYERS.

COMPARABILITY ANALYSIS

THE FIRST ISSUE YOU HAVE RAISED IS WHETHER THE RETIREMENT SYSTEM SHOULD BE CONSIDERED BY ITSELF OR WHETHER CONSIDERATION SHOULD BE EXPANDED TO INCLUDE OTHER BENEFITS AND CASH COMPENSATION. WE BELIEVE THIS QUESTION SHOULD BE LOOKED AT FROM TWO PERSPECTIVES. FIRST, WE DO BELIEVE IT MAKES SENSE, WHEN CONSIDERING RETIREMENT REFORMS, THAT ONE CONSIDER THE WHOLE

RANGE OF COMPENSATION PROGRAMS AVAILABLE TO THE PUBLIC AND PRIVATE SECTORS. SECOND, BECAUSE THESE BENEFITS' TOTALS DIFFER DRAMATICALLY AND BECAUSE DIFFERENT PREFERENCE PATTERNS PROBABLY EXIST IN EACH SECTOR, IT BECOMES OBVIOUS THAT ONE SHOULD NOT ATTEMPT TO TOTALLY OVERHAUL THE WHOLE BENEFITS AND PAY SYSTEM ALL AT ONCE. THE DIFFERENCES BETWEEN GOVERNMENT AND THE PRIVATE SECTOR ARE SIMPLY TOO PERVASIVE TO MAKE A TOTAL OVERHAUL PRACTICAL.

YOU WILL RECALL THAT BOTH THIS AND THE PREVIOUS ADMINISTRATION ATTEMPTED TO PRESENT A "TOTAL COMPENSATION COMPARABILITY" (TCC) APPROACH TO FEDERAL PAY AND BENEFITS. HOWEVER, THE ADMINISTRATION WITHDREW ITS TOTAL COMPENSATION APPROACH IN FAVOR OF AN APPROACH THAT WOULD SEPARATELY ADDRESS PAY AND BENEFITS. THIS HAS BEEN THE APPROACH TAKEN IN THE FY-84 AND FY-85 BUDGETS. WE BELIEVE THIS APPROACH IS MORE POSITIVE, AND MORE RESPONSIVE TO THE VIEWS PRESENTED BY CONGRESS AND THIS COMMITTEE WHEN YOU CONSIDERED THE TCC APPROACHES OF BOTH ADMINISTRATIONS.

THE DIFFICULTY IN MAKING A TCC COMPARISON CAN BE SEEN WHEN ONE LOOKS CLOSELY AT PRIVATE AND PUBLIC SECTOR BENEFITS. IN MAKING THE COMPARISON, WE ATTEMPTED TO LOOK AT ALL BENEFITS, TO ANSWER A QUESTION RAISED IN YOUR LETTER, AND AT ALL OF THE MAJOR STUDIES WHICH HAVE MADE SUCH A COMPARISON. AN APPENDIX TO THIS TESTIMONY SHOWS EACH BENEFIT ELEMENT PRESENTED SEPARATELY.

FOUR ESTIMATES OF THE PRIVATE SECTOR ARE PRESENTED: (1) A CHAMBER OF COMMERCE STUDY WHICH IS BROADLY REPRESENTATIVE OF THE PRIVATE SECTOR BECAUSE IT INCLUDES A REPRESENTATIVE SAMPLE OF SMALL FIRMS, (2) THE GRACE COMMISSION SURVEY WHICH LOOKED AT LARGE CORPORATIONS BUT DID INCLUDE SOME SMALL FIRMS, (3) THE STUDY DERIVED FROM THE PROFESSIONAL, ADMINISTRATIVE, TECHNICAL AND CLERICAL (PATC) SURVEY USED BY OPM IN ITS PREVIOUS TCC COMPARISON OF ESSENTIALLY LARGE FIRMS, (4) AND A HAY ASSOCIATES STUDY IN WHICH LARGE FIRMS PREDOMINATED. THE COST ESTIMATES ARE BASED UPON COST TO THE EMPLOYER, AS A PERCENT OF PAYROLL. THE METHODOLOGIES OF THE STUDIES DIFFER, AS TO THE YEARS. THE GRACE COMMISSION SURVEY AND THE FEDERAL SECTOR SURVEY WERE BOTH DONE IN 1983. THE YEARS OF THE OTHER STUDIES ARE CLOSE ENOUGH, HOWEVER, TO MAKE SOME GENERALIZATIONS.

THE SURVEY BY THE CHAMBER OF COMMERCE COVERED EMPLOYEES NON-EXEMPT FROM THE FAIR LABOR STANDARDS ACT AND INVOLVES LARGE AND SMALL FIRMS. THAT SURVEY SUGGESTS THAT THE GOVERNMENT PAYS 16 PERCENT OF PAYROLL MORE FOR FUNDED BENEFITS THAN DOES THE PRIVATE SECTOR. ON THE OTHER HAND, IF ONE JUST LOOKS AT LARGE FIRMS, WITH SIZABLE REPRESENTATION OF BOTH EXEMPT AND NON-EXEMPT EMPLOYEES THE HAY ASSOCIATES STUDY SUGGESTS THAT THE FEDERAL GOVERNMENT ONLY PAYS 5 PERCENT MORE ON FUNDED BENEFITS. DIRECTLY COMPARING 1983 BENEFIT LEVELS, USING THE GRACE COMMISSION WHICH HAS A SMATTERING OF SMALL FIRMS, SUGGESTS THAT THE GOVERNMENT PAYS 14 PERCENT MORE IN FUNDED BENEFITS THAN THE PRIVATE SECTOR.

ALTHOUGH THESE ESTIMATES OF FUNDED BENEFITS WERE DEVELOPED USING DIFFERENT METHODOLOGIES, WHEN ONE INCLUDES UNFUNDED BENEFITS IN THE

COMPARISON, THESE METHODOLOGICAL DIFFERENCES ARE NOT SIGNIFICANT. UNFUNDED LIABILITY PAYMENTS ARE NOT A PART OF ACTUARIAL NORMAL COSTS, BUT THEY ARE A REAL COMPONENT OF RETIREMENT COSTS FOR A PRIVATE SECTOR COMPANY. IF THE FEDERAL GOVERNMENT WERE REQUIRED TO MAKE PAYMENTS ON THE UNFUNDED LIABILITY OF THE CIVIL SERVICE RETIREMENT SYSTEM IN THE SAME WAY THAT THE PRIVATE COMPANIES ARE REQUIRED TO UNDER ERISA THEN ITS ANNUAL PAYMENT WOULD BE 55.4 PERCENT OF PAYROLL FOR 40 YEARS. AT A MINIMUM USING THE HIGHEST ESTIMATE OF THE PRIVATE SECTOR, THE FEDERAL GOVERNMENT WOULD HAVE TO PAY ALMOST TWICE THE BENEFITS PAID BY THE PRIVATE SECTOR, AS A PERCENTAGE OF PAYROLL,(109% OF PAYROLL VERSUS 55%). THIS DOES NOT CONSIDER SOCIAL SECURITY'S UNFUNDED LIABILITY, BUT SINCE THREE-FOURTHS OR MORE OF FEDERAL EMPLOYEES WILL ULTIMATELY RECEIVE SOCIAL SECURITY TOO, THIS IS APPROPRIATE.

WHEN ONE LOOKS AT THE TOTAL BENEFITS COST, IT BECOMES CLEAR WHY THE TCC APPROACH IS TOO RADICAL. EVEN IF ONE ACCEPTED THE QUESTIONABLE RESULTS OF THE PATC SALARY SURVEY (WHICH FEW DO), AND THE MOST MODEST SURVEY OF PRIVATE BENEFITS, COMPARABILITY WOULD DEMAND SUCH A DRAMATIC INCREASE IN BENEFITS AND PAY FOR FEDERAL EMPLOYEES THAT ANY SUCH CONSIDERATION WOULD BE UNREALISTIC.

IT IS, OF COURSE, TRUE THAT EVEN A STUDY LIMITED TO A COMPARISON OF RETIREMENT BENEFITS SHOWS A DECIDED ADVANTAGE TO THE FEDERAL SECTOR. THIS TRUTH SHOULD SHAPE OUR VIEWS WHEN WE ATTEMPT TO DEVELOP A NEW RETIREMENT PACKAGE, AS WELL AS WHEN WE CONSIDER CHANGES TO THE PRESENT RETIREMENT SYSTEM FOR EXISTING EMPLOYEES. BUT LIMITING THE DEBATE TO RETIREMENT ONLY MAKES THE DEBATE MANAGEABLE. OTHERWISE, WE WOULD BE FORCED TO ARGUE FOR REDUCTIONS IN BENEFITS AND SALARY ACROSS THE BOARD, GIVEN THE TCC APPROACH, WITH ONLY A FEW MINOR EXCEPTIONS. THE MORE CONSTRUCTIVE ROUTE IS TO LOOK AT RETIREMENT BENEFITS BY THEMSELVES AND MAKE THEM COMPARABLE TO PRIVATE SECTOR PRACTICES, ALTHOUGH NOT NECESSARILY EQUIVALENT TO THEM.

GENERAL DESIGN

YOU NEXT ASKED WHETHER WE SHOULD LOOK AT A DEFINED BENEFIT OR A DEFINED CONTRIBUTION PLAN, OR PERHAPS A COMBINATION OF THE TWO. THIS IS CERTAINLY ONE OF THE MOST IMPORTANT QUESTIONS TO BE DECIDED, AND ONE WHERE WE ARE PARTICULARLY EAGER TO HEAR THE VIEWS OF OTHERS, ESPECIALLY THE VIEWS OF AFFECTED FEDERAL EMPLOYEES.

FORTUNATELY, OUR 1983 FEDERAL EMPLOYEE ATTITUDE SURVEY (FEAS) HAS ALREADY SHED SOME LIGHT ON EMPLOYEE ATTITUDES ON THIS MATTER. WHEN A REPRESENTATIVE SAMPLE OF FEDERAL EMPLOYEES (INVOLVING 20,000 RESPONSES IN THE FEAS), WAS ASKED TO CHOOSE BETWEEN DIFFERENT RETIREMENT OPTIONS, THE TWO FAVORITE CHOICES AMONG THOSE OFFERED ARE THE PRESENT DEFINED BENEFITS SYSTEM WITH A SUBSTANTIAL INCREASE IN EMPLOYEE CONTRIBUTIONS EVEN TO 17 PERCENT OF PAYROLL, AND A PLAN WHERE THE GOVERNMENT WOULD SET UP AN ANNUITY AND CONTRIBUTE 11 PERCENT OF PAYROLL WHILE EMPLOYEES WOULD ADD WHATEVER THEY WANTED ON TOP OF IT. THE WAY THE RESPONSES WERE WORDED, THERE ARE SIMILARITIES BETWEEN THE FORMER AND A DEFINED BENEFITS APPROACH, AND THE LATTER AND A DEFINED CONTRIBUTION PROGRAM.

SPECIFICALLY, THE QUESTION WAS, "IF YOU HAD A CHOICE, WHICH OF THE FOLLOWING WOULD YOU CHOOSE AS A PENSIONS SYTEM?"

1) SOCIAL SECURITY BENEFITS AND CONTRIBUTIONS ONLY--THEN RELY ON YOUR OWN PERSONAL SAVINGS OR IRA TO SUPPLEMENT SOCIAL SECURITY (GOVERNMENT AND EMPLOYEE EACH CONTRIBUTE 5.6 PERCENT OF PAYROLL): 2.6 OF FEDERAL EMPLOYEES.

2) SOCIAL SECURITY PLUS BENEFITS AND CONTRIBUTIONS FOR A MODIFIED CIVIL SERVICE RETIREMENT SYSTEM TO SUPPLEMENT SOCIAL SECURITY (GOVERNMENT AND EMPLOYEE EACH CONTRIBUTE 11 PERCENT): 10.8 PERCENT OF FEDERAL EMPLOYEES.

3) PRESENT CIVIL SERVICE RETIREMENT BENEFITS AS THEY ARE--EVEN IF IT MEANS YOU MAY HAVE TO SUBSTANTIALLY INCREASE YOUR CONTRIBUTION TO 17 PERCENT: 31.9 PERCENT OF FEDERAL EMPLOYEES.

4) LOWER CIVIL SERVICE RETIREMENT BENEFITS OUTSIDE SOCIAL SECURITY--IF IT MEANS THAT YOUR CONTRIBUTION TO THE SYSTEM WILL NOT BE INCREASED FROM THE PRESENT 7 PERCENT: 6.5 PERCENT OF FEDERAL EMPLOYEES.

5) A RETIREMENT SYSTEM IN WHICH MONEY WOULD BE DEPOSITED IN AN APPROVED PRIVATE ANNUITY ACCOUNT--THE GOVERNMENT WOULD CONTRIBUTE 11 PERCENT OF PAYROLL AND YOU WOULD ADD WHATEVER YOU WANT: 41.6 PERCENT OF FEDERAL EMPLOYEES.

6) NO CHOICE BETWEEN THE ABOVE WAS MADE BY 6.7 PERCENT OF FEDERAL EMPLOYEES.

THE FEAS ALSO CLEARLY SHOWS THAT FEDERAL EMPLOYEES PREFER DEFERRED BENEFITS SUCH AS RETIREMENT, OVER IMMEDIATE COMPENSATION SUCH AS SALARY. ONLY 21 PERCENT SAID THAT THEY WOULD RATHER HAVE MORE TAKE HOME PAY NOW WITH LOWER RETIREMENT BENEFITS, AS OPPOSED TO 52.7 PERCENT WHO SAID THEY WOULD RATHER HAVE LESS TAKE HOME PAY NOW WITH HIGHER RETIREMENT BENEFITS LATER.

IT IS IMPORTANT TO NOTE THAT FEDERAL EMPLOYEES DO NOT HAVE A UNIFORM OPINION ON HOW THE RETIREMENT SYSTEM SHOULD BE STRUCTURED. WE KNOW THAT A TRADITIONAL DEFINED BENEFIT PLAN, SUCH AS THE CURRENT CIVIL SERVICE RETIREMENT SYSTEM, IS VERY ATTRACTIVE TO MANY EMPLOYEES. THIS IS SO BOTH BECAUSE IT IS WHAT THEY ARE USED TO AND BECAUSE IT AT LEAST APPEARS TO OFFER MORE CERTAIN BENEFITS UPON RETIREMENT. HOWEVER, THERE IS NO INHERENT REASON WHY EITHER THE COSTS OR THE BENEFITS ULTIMATELY RECEIVED SHOULD BE ANY DIFFERENT OR LESS CERTAIN UNDER THE TWO TYPES OF PLANS.

WE ARE INCLINED TO THINK THAT DEFINED CONTRIBUTION PLANS ARE VERY ATTRACTIVE BECAUSE, BY THEIR NATURE, THEY ARE FULLY FUNDED AND THERE IS NO RISK OF GETTING INTO THE KINDS OF FINANCIAL SITUATIONS WE BELIEVE THE CURRENT RETIREMENT SYSTEM NOW FACES. EMPLOYEES' CONCERNS ABOUT FUTURE BENEFITS CAN BE DEALT WITH BY TYING SECURITIES INCOME TO SOME OBJECTIVE DEVICE, SUCH AS THE CURRENT TREASURY BILL RATE, OR SOME ECONOMIC INDICATOR. THESE CHARACTERISTICS MAY MAKE IT POSSIBLE TO PROVIDE LONG TERM ASSURANCE TO EMPLOYEES ABOUT THE STABILITY OF THEIR RETIREMENT PLAN, EVEN THOUGH DONE THROUGH DEFINED CONTRIBUTION.

WITH RESPECT TO THE SPECIFIC RELATIONSHIP BETWEEN BENEFITS UNDER THE NEW PLAN AND SOCIAL SECURITY BENEFITS--WHETHER, FOR INSTANCE, WE SHOULD HAVE AN "INTEGRATED" OR AN "OFFSET" APPROACH--WE HAVE NO FIXED VIEW. CERTAINLY ONE MAJOR FACTOR TO BE CONSIDERED HERE WILL BE WHETHER BENEFITS COMMENCE AT THE SAME TIME AS SOCIAL SECURITY BENEFITS OR AT AN EARLIER AGE. WE ALSO HOPE THAT ANY LINKAGE BETWEEN BENEFITS SYSTEMS WILL TAKE INTO ACCOUNT THE VERY REAL ADMINISTRATIVE DIFFICULTIES THAT COULD OCCUR IN THIS AREA. WE NOTE THAT SEVERAL STATE GOVERNMENTS HAVE ADDRESSED THIS PARTICULAR QUESTION RECENTLY AND THEIR EXPERIENCES MIGHT BE INSTRUCTIVE FOR THE FEDERAL SECTOR. IN THIS REGARD, MANY OF THEM HAVE NOT PRECISELY INTEGRATED THE TWO BECAUSE OF THE LACK OF ADMINISTRATIVE FEASIBILITY IN DOING SO.

ELIGIBILITY AND INFLATION PROTECTION

WE FULLY RECOGNIZE THAT RETIREMENT AGE AND INFLATION PROTECTION ARE VERY LIKELY TO BE THE MOST CONTROVERSIAL AND DIFFICULT ISSUES THAT MUST BE DECIDED. I THINK THAT MOST OBSERVERS WOULD AGREE THAT IT IS IN THESE TWO AREAS THAT THE CURRENT CIVIL SERVICE RETIREMENT SYSTEM IS MOST UNLIKE PRIVATE SECTOR PLANS. AND I AM PERSONALLY CONVINCED THAT REFORMS ARE GOING TO HAVE TO BE MADE UNDER THE CURRENT RETIREMENT SYSTEM, AS FOR THE NEW PLAN, BOTH OF THESE ISSUES ARE CRITICAL.

THE PRESIDENT'S 1984 BUDGET ADDRESSED THE NEED TO REMOVE THE INCENTIVES FOR EMPLOYEES TO RETIRE EARLY, AT THE PEAK OF THEIR CAREERS, WHILE THEY STILL HAVE SUCH A VALUABLE CONTRIBUTION TO MAKE IN TERMS OF THEIR EXPERTISE AND INSTITUTIONAL KNOWLEDGE. THIS NEED REMAINS A PARAMOUNT PERSONNEL MANAGEMENT CONSIDERATION.

THE PRESIDENT'S BUDGET FOR FISCAL YEAR 1985 INCLUDES PROPOSALS FOR WHAT WE BELIEVE TO BE THE RIGHT APPROACH TO INFLATION PROTECTION. FIRST, COST-OF-LIVING ADJUSTMENTS WOULD BE LIMITED TO THE LESSOR OF PRICE INCREASES OR FEDERAL WAGE INCREASES. SECOND, FULL INDEXATION WOULD ONLY APPLY TO AND TO THE FIRST $10,000 OF ANNUITY--APPROXIMATELY EQUIVALENT TO THE MAXIMUM PRIMARY SOCIAL SECURITY BENEFIT--AND AN ANNUITY ABOVE THIS AMOUNT WOULD RECEIVE ONLY 55 PERCENT OF THE COST-OF-LIVING ADJUSTMENT. WE BELIEVE THIS APPROACH WOULD MUCH MORE CLOSELY RESEMBLE WHAT RETIREES RECEIVE IN THE PRIVATE SECTOR, WHERE ONLY THE SOCIAL SECURITY BENEFIT IS FULLY INDEXED AND WHERE ANY INCREASE IN PRIVATE PENSIONS BENEFITS ARE ONLY PARTIAL OR AD HOC.

OUR TCC COMPARISON, SHOWN ABOVE, RAISES QUESTIONS ABOUT YOUR PREMISE THAT FEDERAL RETIREMENT SYSTEM COSTS ARE MORE THAN OFFSET BY "SHORTFALLS" IN OTHER BENEFITS. I ONLY MENTION THAT BECAUSE YOUR LETTER RAISES THAT ISSUE HERE. YET, THAT GETS AWAY FROM THE PRINCIPAL FOCUS OF THIS HEARING. I AM PARTICULARLY INTRIGUED, HOWEVER, BY YOUR SUGGESTION THAT IT MIGHT BE POSSIBLE TO STRUCTURE THE INDEXATION FEATURE TO REDUCE COSTS IN ORDER TO OFFER SOME SORT OF THRIFT PLAN. WE WOULD VERY MUCH LIKE TO WORK WITH YOU ON THIS SUBJECT.

ONE ADDITIONAL POINT ON THE RETIREMENT ELIGIBILITY QUESTION: WE DO HAVE CERTAIN SPECIAL GROUPS OF EMPLOYEES UNDER CIVIL SERVICE RETIREMENT, SUCH AS LAW ENFORCEMENT OFFICERS, FIREFIGHTERS, AND AIR TRAFFIC CONTROLLERS, AS WELL AS THE PERSONS COVERED BY THE FOREIGN SERVICE AND CIA RETIREMENT SYSTEMS, FOR WHOM SPECIAL ARRANGEMENTS MAY BE NECESSARY UNDER THE NEW PLAN SIMILAR TO THOSE UNDER THE CURRENT RETIREMENT SYSTEM. IT IS SIMPLY NOT FEASIBLE FOR SOME EMPLOYEES TO CONTINUE TO WORK IN POSITIONS REQUIRING A YOUNG AND VIGOROUS WORKFORCE UNTIL SOCIAL SECURITY BENEFITS COMMENCE. STILL, CONSIDERABLE WORK MAY NEED TO BE DONE TO RATIONALIZE AND UPDATE DEFINITIONS OF WHO SHOULD BE COVERED IN THESE SPECIAL GROUPS, WHAT RETIREMENT AGE IS APPROPRIATE, AND PRECISELY WHAT THEIR BENEFITS SHOULD BE.

FUNDING

AS IS WELL KNOWN, I HAVE BEEN VERY CRITICAL OF THE FUNDING ARRANGEMENTS UNDER THE CURRENT CIVIL SERVICE RETIREMENT SYSTEM. THE FUNDING SYSTEM THAT HAS BEEN IN USE, WHILE PRODUCING TECHNICAL SOLVENCY, HAS ALLOWED AN ACCUMULATION OF A HUGE UNFUNDED LIABILITY--NOW $515 BILLION ON A DYNAMIC BASIS--ESSENTIALLY OBLIGATING TOMORROW'S CITIZENS TO PAY A MAJOR PORTION OF THE COSTS FOR THE SERVICES WE ARE RECEIVING FROM FEDERAL EMPLOYEES TODAY. THE SIZE OF THIS MUSHROOMING LIABILITY HAS CAUSED GROWING APPREHENSION AMONG A BROAD SPECTRUM OF OBSERVERS, AND SHOULD BE A SOURCE OF GREAT CONCERN TO FEDERAL EMPLOYEES TOO--SINCE THEY MUST COMPLETELY RELY ON THE BENEFICIENCE OF TOMORROW'S TAXPAYERS TO PAY THE COSTS OF A RETIREMENT SYSTEM THAT IS GENEROUS WHEN COMPARED TO THE PRIVATE SECTOR.

FOR THIS REASON, I FEEL VERY STRONGLY THAT ANY NEW RETIREMENT PLAN WE ESTABLISH MUST BE FULLY FUNDED ON A CURRENT BASIS, SO THAT BOTH EMPLOYEES AND TAXPAYERS WILL KNOW THAT THE FEDERAL BUDGET RECOGNIZES THE LIABILITY TO PAY THOSE BENEFITS AS THEY ACCRUE.

WITH RESPECT TO WHETHER THE MONEY FOR THE NEW PLAN SHOULD BE HELD WITHIN THE CURRENT CIVIL SERVICE RETIREMENT FUND, OR HELD SEPARATELY, WE HAVE NO FIXED OPINION. HOWEVER, I DO WISH TO STRESS TWO POINTS THAT I BELIEVE ARE VERY IMPORTANT HERE.

FIRST, ALTHOUGH IT PROBABLY WILL BE NECESSARY TO FUND THE SYSTEM WITHIN GOVERNMENT, I DO NOT THINK WE SHOULD USE THE MONEY BEING PUT ASIDE ON BEHALF OF EMPLOYEES UNDER THE NEW PLAN TO PAY BENEFIT LIABILITIES ACCRUED UNDER THE CURRENT CIVIL SERVICE RETIREMENT SYSTEM. THIS IS INCONSISTENT WITH THE REQUIREMENTS OF A BONA FIDE TRUST FUND, AND SHOULD BE AVOIDED.

SECOND, WHILE WE ARE CREATING A NEW RETIREMENT PLAN, I BELIEVE WE MUST MAKE APPROPRIATE ARRANGEMENTS TO ENSURE THAT THE CURRENT CIVIL SERVICE RETIREMENT SYSTEM REMAINS ABLE TO MEET ITS OBLIGATIONS FOR THE NOW-CLOSED WORKFORCE IT COVERS, ESPECIALLY AS EMPLOYEES MATURE AND RETIRE. ONE WAY THAT THIS COULD MOST BE DONE BY CREATING A NEW ACTUARIAL ESTIMATE OF THE UNFUNDED LIABILITY AND THE CURRENT 30 YEAR PAYMENTS AND DETERMINING AN APPROPRIATE AMORTIZATION SCHEDULE WHICH WOULD RISE AS EMPLOYEE AND AGENCY CONTRIBUTIONS DECLINE. THIS WOULD GUARANTEE THE INTREGRITY OF THAT SYSTEM AND ALLOW US TO PAY FUTURE BENEFITS. THIS WOULD NOT BE SUCH ANOVERWHELMING BURDEN ON FUTURE TAXPAYERS IF SOME REDUCTIONS IN CURRENT BENEFITS ARE MADE AT THE SAME TIME. NONETHELESS, IT IS NECESSARY TO GUARANTEE THAT THE OBLIGATION TO CURRENT EMPLOYEES, HOWEVER MODIFIED, IS ACTUALLY PAID.

WE HAVE AN OPEN MIND WITH RESPECT TO WHETHER THE PLAN SHOULD BE CONTRIBUTORY OR NON-CONTRIBUTORY FOR ITS EMPLOYEE PARTICIPANTS. OF COURSE, EMPLOYEES WILL BE CONTRIBUTING TOWARDS SOCIAL SECURITY AND, IN THAT SENSE, MUST MAKE CONTRIBUTIONS. PROBABLY SOME LEVEL OF CONTRIBUTIONS ABOVE THAT MAKES SENSE, GIVEN EMPLOYEE PREFERENCES FOR HIGH RETIREMENT BENEFITS, BUT WE ARE WILLING TO DISCUSS OTHER ALTERNATIVES.

COVERAGE

WITH RESPECT TO COVERAGE UNDER THE NEW PLAN, WE HOPE THAT IT WILL HAVE ATTRACTIVE FEATURES FOR CURRENT EMPLOYEES. ONE MAJOR CHARACTERISTIC OF THE PRESENT RETIREMENT SYSTEM IS THAT IT REWARDS LONG-SERVICE EMPLOYEES BETTER THAN IT DOES SHORT-SERVICE EMPLOYEES. HAVING COVERAGE UNDER SOCIAL SECURITY WILL IMMEDIATELY BE ATTRACTIVE TO SHORT-SERVICE EMPLOYEES BECAUSE SOCIAL SECURITY IS PORTABLE. IF GIVEN THE CHOICE, SOME EMPLOYEES--ESPECIALLY THOSE AT THE LOWER INCOME LEVELS--WILL FIND IT ATTRACTIVE TO SWITCH, WHATEVER THE OTHER BENEFITS. THIS IS BECAUSE SOCIAL SECURITY "TILTS" TOWARD LOW INCOME RETIREES. IF THE NEW PLAN OFFERS MORE PORTABILITY OF BENEFITS--AS WE THINK IT PROBABLY SHOULD--THERE WILL CERTAINLY BE GREAT INTEREST ON THE PART OF SOME CURRENT EMPLOYEES TO MOVE TO THE NEW PLAN, AND WE ARE INCLINED TO THINK THEY SHOULD BE ABLE TO DO SO.

IN CLOSING, I WOULD LIKE TO EXPRESS ONCE AGAIN OUR READINESS TO WORK WITH THE COMMITTEE AND OTHER INTERESTED PARTIES ON THESE AND OTHER ISSUES. WE APPRECIATE THE COMMITTEE'S TIMELY CONSIDERATION OF THESE DISCUSSIONS AND I WOULD BE HAPPY TO ANSWER ANY QUESTIONS THE COMMITTEE MAY HAVE.

APPENDIX; COMPARISON OF EMPLOYER COSTS FOR BENEFITS, FEDERAL AND PRIVATE SECTOR

COMPARISON OF EMPLOYER COSTS FOR BENEFITS, FEDERAL AND PRIVATE SECTOR
(PERCENT OF BASIC PAY)

	Private Sector Benefits					
	I	II	III	IV	V	VI
	U S Chamber of Commerce (Small firms included)	Grace Commission	PATC Survey Analysis (Large and medium firms)	Hay Associates (Large firm emphasis)	Hay/C of C (I & IV) (Joint private est.)	Federal Sector
	1981	1983	1980	1982		1983
1. Pensions and Legally Required Payments						
(a) OASDI(FICA), Pensions/Retirement	11.5	12.4	17.1[B]	15.5[B]	15.5[B]	29.5
(b) Unemployment Compensation	1.2	1.5	A	A	A	A
(c) Workers Compensation (FECA)	1.4	1.7	A	A	1.4	1.4[J]
(d) Railroad Retirement Tax	0.1	A	A	A	A	A
2. Other Agreed-upon Payments						
(a) Health Insurance, Life Ins., Death Benefits	6.0	6.5	5.8	7.3	7.3	4.5
(b) Short Term Disability	0.4	C	C	C	C	C
(c) Long Term Disability	0.2	G	0.1	0.1	0.1	G
(d) Dental Ins. Premiums	0.4	D	D	D	D	D
(e) Employee Discounts	0.1	A	0.1	0.1	0.1	F
(f) Meals Furnished by Employer	0.2	A	E	E	E	A

	Private Sector Benefits					
	I	II	III	IV	V	VI
	U S Chamber of Commerce (Small firms included)	Grace Commission	PATC Survey Analysis (Large and medium firms)	Hay Associates (Large firm emphasis)	Hay/C of C (I & IV) (Joint private est.)	Federal Sector
	1981	1983	1980	1982		1983
(g) Miscellaneous (Vision Care, Prescription Drugs, Separation Pay/Severance Pay, Moving Expenses, etc.)	0.2	A	F	F	F	0.2
3. Paid Rest Periods, Lunch Periods, Travel Time, Wash-up Time, etc.	3.4	3.7	3.8	3.8	3.8	2.0
4. Payments for Time Not Worked						
(a) Paid Vacations	5.0	5.2	5.9			7.7
(b) Paid Holiday Not Worked	3.4	3.6	3.9			3.4
(c) Paid Sick Leave	1.3	1.8	1.8	12.8	12.8	3.5
(d) Misc. Payments for Nonwork Time; Jury Duty, Voting, Personal Reasons, Guard Duty, Family Death, or Other	0.3	0.3	0.3			0.3[J]

	Private Sector Benefits					
	I	II	III	IV	V	VI
	U S Chamber of Commerce (Small firms included)	Grace Commission	PATC Survey Analysis (Large and medium firms)	Hay Associates (Large firm emphasis)	Hay/C of C (I & IV) (Joint private est.)	Federal Sector
	1981	1983	1980	1982		1983
5. Other Items						
(a) Profit Sharing Payments	1.1	1.6	2.4	2.4	2.4	F
(b) Thrift/Capital Accumulation Plan	0.4	H	1.1	2.1	2.1	F
(c) Bonuses: Xmas/Other Awards: Suggestion/Other, etc.	0.3	0.4	0.9	0.9	0.9	0.3[J]
(d) Employee Education Expenditures	0.2	A	0.1	0.1	0.1	0.2
(e) Special Wage Payments Ordered By Courts to Union Stewards, etc.	0.2	A	A	A	A	A
(f) Auto Parking and Personal Use	A	A	0.8	0.8	A	A
(g) Other Miscellaneous Benefits	A	0.7	0.6	0.6	0.6	0.6
Total as Percent of Payroll	37.3%	39.4%	44.7%	46.5%	47.1%	53.6%
6. Unfunded Pension Liability	N.A.[K]	N.A.[K]	8.0[K]	8.0[K]	8.0[K]	55.4
Grand Total as Percent of Payroll	37.3%	39.4%	52.7%	54.5%	55.1%	109.0%

FOOTNOTES

A. Not in survey.

B. The Hay and TCC retirement results are higher than those for the Chamber and Grace Commission largely because of a difference in the estimated value of the Social Security benefit. The Chamber and Grace Commission Social Security figures, 6.3% and 6.2% respectively, are strictly on an employer outlay basis. The Hay (15.5%) and TCC (17.1%) total retirement figures are based on the estimated normal cost of Social Security which exceeds combined employer and employee outlays. The Hay estimate of the employer cost of Social Security (post-1983 reform) is 7.0% while the TCC estimate (pre-1983 reform) is 8.2%. Also, Hay and TCC include factors of 1.7% and 2.0%, respectively, for the Social Security tax advantage. The Chamber and Grace Commission do not include tax advantage. If done on a consistent basis with the Chamber and Grace Commission, the Hay and TCC retirement values would be 13.0% and 13.1%, respectively.

C. Included in sick leave benefit.

D. Included in health insurance benefit.

E. Included in other miscellaneous benefits.

F. Less than 0.1%.

G. Included in pension benefit.

H. Included in profit-sharing benefit.

I. Basic data from Table IV-3, report of Grace Commission Task Force on Personnel Management, converted to percent of total basic payroll using FY 1981 ratio of Total Payroll Accounts to Total Basic Payroll (1.0679) from Table IV-1 of report.

J. From Grace Commission report.

K. OPM estimate - 1981 Schedule B statistics from the Department of Labor indicate that the average amortization charge for plans funded under the "Entry Age" Normal Actuarial Cost Method is 116 percent of the average employer normal cost. The OPM's 1980 TCC analysis estimated the average employer normal cost to be 6.9 percent of payroll and 116 percent of that figure yields 8.0 percent of payroll as an unfunded liability payment. This "Entry Age" method yields the highest proportion of unfunded liability payments to normal costs. Thus actual payments may be somewhat lower. The Chamber of Commerce and Grace Commission figures are based on actual expenses and thus already include the payment towards the unfunded liability in the private sector pension cost on line 1(a).

SURVEY SOURCES

I. U. S. Chamber of Commerce, "Employee Benefits - 1981."

II. President's Private Sector Survey on Cost Control, "Report of the Task Force on Personnel Management", April 15, 1983 (Grace Commission).

III. U. S. Office of Personnel Management, unpublished 1980 data.

IV. Hay Associates, "Comparability of Federal and Private Sector Non-Cash Compensation - 1982."

V. Hay Associates (column IV) data where available. Remaining data are from U.S. Chamber of Commerce (column I).

VI. U. S. Office of Personnel Management data, except as indicated.

Comparison of Federal and Private Sector Employer Costs for Benefits, Survey Information

I. **U.S. Chamber of Commerce, "Employee Benefits - 1981."**

- Survey Participants: 994 manufacturing and non-manufacturing companies. (52 percent manufacturing, 48 percent non-manufacturing.) Participants included firms reporting in the Chamber's 1979 and 1980 surveys, plus samples of firms from Poors Register of Corporations, Directors and Executives 1981 (omitting firms with fewer than 100 employees). Survey results reflect simple averaging of establishment values with no correction for non-respondents.
- Employees Covered: Generally non-exempt from FLSA. The largest group of respondents had between 5 and 499 employees (41%); 17% had between 500 and 999 employees; 19% had between 1,000 and 2,499 employees; 11% had between 2,500 and 4,999 employees; and 12% had 5,000 or over.

II. **The President's Private Sector Survey on Cost Control (Grace Commission) "Report of the Task Force on Personnel Management, April 1983."**

- Primary Survey Sources: Hay Associates Non-Cash Compensation Survey, 1982 (described above).
  Bankers Trust Company, "Corporate Pension Plan Study, a Guide for the 1980's."
- Survey Participants (Bankers Trust): A total of 240 companies in 55 different industrial categories.
- Employees covered (Bankers Trust): More than 8,200,000 employees under 325 different benefit plans.

III. **U.S. Office of Personnel Management, (TCC Results) Unpublished 1980 Data**

- Survey Sources: USDL, Bureau of Labor Statistics survey of Level of Benefits (LOB) among 1,469 establishments (mining, construction, manufacturing, transportation and others). This survey was conducted using the same survey universe as the annual survey of Professional Administrative, Technical and Clerical Pay (PATC), with data analysis conducted by OPM. This survey involved random selection and the results were corrected for non-respondents and weighted by number of plan participants in each establishment.
- Employees Covered: Survey represents 21 million employees in Professional-Administrative, Technical-Clerical, and Production occupations.
- Participant Distribution: The survey respondents were in metropolitan and non-metropolitan areas within the 48 contiguous states.

IV. Hay Associates, "Comparability of Federal and Private Sector Non-Cash Compensation - 1982."

- Hay conducted an update of OPM's 1979 Federal and private benefit data using their proprietary data base as described below.
- Survey Participants: 805 manufacturing and non-manufacturing companies. (36 percent manufacturing, 64 percent non-manufacturing and services.)
- Employees Covered: FLSA exempt and non-exempt salaried and hourly employees. The survey respondents were predominantly medium and large employers; Less than 5% of the respondents had fewer than 100 employees; 23% had between 100 and 999 employees; 40% had between 1,000 and 4,999 employees; and 34% had in excess of 5,000 employees.
- Participant Distribution: Most of the survey respondents were in the Mid-Atlantic states (34%); 21% were in the Central states; 16% in the South; 9% in the Plains states; 8% on the West Coast; 8% in the Northeast; and 3% in the Mountain states.

V. Hay and Chamber of Commerce

- Hay Associates (Source IV) survey data where applicable. Remaining data are from U. S. Chamber of Commerce (Source I) survey.

V. Federal Benefits

- Data sources: OPM actuarial, financial and personnel data (excluding USPS).

° FEHBP contributions	- Calendar yr. 1983
° CSRS normal cost	- Fiscal yr. 1982
° FEGLI contributions	- Calendar yr. 1983
° Leave usage and accrual	- Calendar yr. 1980
° Other Federal benefits	- 1980 TCC data